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TAGS: ECON EFIN EINV ETRD VM SOE FINREF
SUBJECT: VIETNAM'S EXTRA-BUDGETARY FINANCING

¶1. (U) Summary: The Development Assistance Fund (DAF) and the Vietnam Postal Savings Company (VPSC) are responsible for an increasingly large share of the Government of Vietnam's (GVN) policy lending efforts. The VPSC raises funds from ordinary citizens through its deposit and transfer services. By law, it is required to lend this money to the DAF, which then makes loans to GVN-prioritized development and infrastructure projects at subsidized rates. Both organizations are difficult to classify and operate outside of the normal regulatory framework for financial institutions. While neither company is more than five years old, the DAF has swelled to a size comparable to those of the four dominant State-owned commercial banks (SOCBs), with a registered capital of about USD 629 million. In 2004, the DAF's outstanding loans were roughly equivalent to 12 percent of 2004 GDP (USD 45.4 billion). There are no immediate plans to equitize either the DAF or the VPSC. End summary.

¶2. (U) Despite marked progress with market-based economic reforms, the GVN appears committed to sustaining some of its State-owned enterprises (SOEs). SOE reforms and privatization to date have focused largely on small and medium enterprise (SME) SOEs, leaving the largest (and often the least profitable) SOEs on the GVN payroll. Balancing this SOE commitment with fiscal austerity has been a challenge. In order to keep a low budget deficit, the GVN has expanded its extra-budgetary lending to SOEs over the last several years. This strategy aims to finance infrastructure improvements and exports as the Vietnamese economy prepares for heightened competition with foreign companies and strong regional economies.

¶3. (U) The DAF is not only the GVN's fastest growing policy lending and development assistance onlending instrument, it is also the largest financial institution in Vietnam in terms of registered capital (which reaches almost USD 629 million). Chartered in 1999 under Decree 50/1999/ND-CP (Decree 50), the DAF works closely with another relatively new entrant to Vietnam's economic scene: the VPSC. This State-run service is reminiscent of the postal savings systems still used by other governments, most notably by Japan. The purpose of the VPSC, which was also established in 1999, is two-fold: to provide deposit and lending services for remote areas beyond the reach of commercial bank branches and to mobilize funding for the DAF. (Note: The following information on the DAF and the VPSC is derived from conversations with GVN officials, various independent assessments by the World Bank, comments to the U.S. working party for Vietnam's World Trade Organization accession, and our study of the DAF and VPSC's recent activities. End note.)

THE DEVELOPMENT ASSISTANCE FUND

¶4. (U) WHAT IT IS AND IS NOT: In practice, the DAF acts as a State development bank. According to its Director for Foreign Capital Management and International Relations Nguyen Thu Thuy Lan, the DAF's mission is to provide capital for projects and enterprises that are identified by the GVN as priority borrowers for policy lending (Note: The term "policy lending" - or "development policy lending" as it is also known - used to be referred to as "adjustment lending" by International Financial Institutions (IFIs). It is a kind of lending targeted at making structural, financial sector and social reforms in order to promote sustainable growth in developing countries. End note.) The DAF also guarantees investments, supports interest rate payments, provides export credit and "onlends" Official Development Assistance (ODA), a term the GVN uses to describe the process of taking funding received from IFIs and lending the money on to private Vietnamese enterprises and projects that will encourage local development and growth. Like a State-owned bank, the DAF both evaluates its projects and manages its own risk.

¶5. (U) Despite its SOCB-like behavior, the GVN technically classifies the DAF as a government-run, non-bank financial institution. This classification reflects

the fact that the DAF does differ from normal SOCB practices in two key areas: the composition of its borrowers and the level of its lending rate.

¶6. (U) RESTRICTIONS ON BORROWERS: Decrees issued by the GVN designate the DAF's eligible borrowers in an annual list of priority industries and sectors. Decree 106/2004/NC-CP (Decree 106), which took effect last year, significantly improves the internal regulatory framework for monitoring the DAF originally set up by Decree 50. Decree 106 makes large cuts to the number of eligible borrowers, and even those who are eligible must demonstrate they are capable of direct repayment, socio-economic efficiency, and feasible business planning. The DAF requires borrowers to post minimum collateral of 30 percent of the loan's value. The DAF does not, however, maintain a fixed collateral rate; it can even be as high as 100 percent, depending on the project's level of risk. Acceptable collateral is normally in the form on fixed assets, such as equipment or machinery, including assets that the loan itself may finance.

¶7. (U) LENDING RATES: In theory, The DAF's lending rate is lower (normally about 80 percent of the commercial rate) and its lending period longer than those of commercial banks. The prime commercial lending rate in September 2005 is 7.5 percent. The Ministry of Finance (MOF) pays the difference between the DAF's subsidized rate and the commercial lending rate through payments in the budget approved each year by the National Assembly. In practice, the MOF-set rate is usually very close to the actual commercial interest rate. Before Decree 106, the DAF was able to vary its lending rate based on risk or State-determined priority. During this time (1999-2003), the DAF even lent money to highly subsidized projects at interest rates as low as zero percent. Now, the DAF lends at a flat rate. DAF officials also note that the DAF does not finance nor guarantee more than 70 percent of the total capital of an investment project.

¶8. (U) REGISTERED CAPITAL: The DAF's VND 10 trillion (USD 629 million) in registered capital theoretically makes it the largest financial institution in Vietnam. However, registered capital is a nominal distinction in Vietnam, reflecting the DAF's maximum legal level of capitalization rather than its actual size. Most of the DAF's capital is liquid, a contrast to the Vietnamese SOCBs' practice of holding large amounts of capital value in Vietnamese real estate, a market considered to be significantly overvalued. At the time it was chartered in 1999, the DAF held approximately VND 3.8 trillion (USD 239 million) in registered capital, and by 2004, the DAF had close to 5 trillion (USD 315 million). The Prime Minister decided this year to allow the DAF to expand to VND 10 trillion (USD 629 million) in registered capital. The DAF's capitalization is made up of about VND 3.4 trillion (USD 214 million) allocated from the GVN's 2001 budget, with VND 3.1 trillion (USD 195 million) transferred from the DAF's predecessor organization, the General Department for Investment and Development. Another VND 200 billion (USD 12.6 million) comes from the total cumulative profits of the DAF's operations over the last four years. Most observers expect that the DAF's capitalization is likely to continue to increase to the new limit of VND 10 trillion (USD 629 million) over the next several years. Many GVN officials believe the DAF will be converted into a more conventional development bank in the future. The DAF can also mobilize additional capital by floating savings bonds, borrowing from the VPSC or borrowing from the Social Insurance Fund (SIF), Vietnam's social security system.

¶9. (U) LIABILITIES: The DAF's largest financing source is ODA. Between 2001 and 2004, the DAF onlent around VND 38 trillion (USD 2.4 billion) in ODA funds to a wide variety of businesses and projects. Surprisingly, the DAF also reserves the legal authority to onlend ODA to foreign governments, though it has yet to exercise this right. The DAF's remaining liabilities come from the VPSC and the SIF. At the end of 2004, the DAF had borrowed nearly VND 5.5 trillion (USD 346 million) from the VPSC. DAF officials expect that the DAF will soon float preferential bonds on the Ho Chi Minh City exchange.

¶10. (U) ASSETS: The DAF is still smaller than the four dominant SOCBs, though its registered capital is comparable in size. While Vietcombank had VND 81.6 trillion (USD 5.13 billion) and Agribank VND 88.4 trillion (USD 5.56 billion) in assets in 2002, the DAF claimed about VND 38.4 trillion (USD 2.42 billion) in outstanding loans since 2004. Since the DAF began lending in 2001, it has kept about 20 percent of its assets in the form of loans to privately owned domestic companies and the remaining 80 percent in loans to SOEs. According to DAF officials, the DAF does not use quotas

or other discriminatory lending practices to determine its loan ratio of public and privately owned companies, though an increase in private sector lending is expected in the near future.

¶11. (U) FUTURE PLANS: The DAF plans to reduce its lending activities and increase its capitalization in the near term, reducing the number of sectors and industries that are eligible for loans. The DAF's export and investment credit operations will also face substantial reductions as part of an effort to increase the DAF's capital-asset ratio, which some DAF officials believe is too low at present.

THE VIETNAM POSTAL SAVINGS COMPANY

¶12. (U) The VPSC was chartered in 1999 as a subsidiary of the Vietnam Post and Telecommunications Corporation (VNPT). The primary objective of the company is to mobilize funding for the development efforts of the DAF. The VPSC also provides valuable banking and financial services to Vietnam's poorer, rural population who may not have access to deposit and cash wiring services. According to VPSC Deputy Director, Cao Thi Hoai Duc, the company follows the same model as Japan's extensive postal savings system does.

¶13. (U) Despite the fact that it is a significant financial institution, the VPSC is quite distinct from an SOCB. Its deposit services are restricted to short-term maturities and it lends solely to the DAF. Duc said the average deposit balance is about VND 10 million (USD 629). Each year, the Ministry of Planning and Investment (MPI) determines how much the VPSC will lend to the DAF. The DAF then borrows the funds at one, two, three or five-year maturities at the same interest rate as fixed-rate government bonds (a rate set by the MOF). Starting in late 2005, the VPSC will conduct lending by purchasing DAF bonds on the securities market. The VPSC itself determines interest rates for depositors, though the rates are more competitive than those of commercial deposit institutions. Deputy Director Duc observed that the VPSC is the nation's most secure deposit institution since all of its funds are transferred to the GVN. In turn, the GVN guarantees the company, making deposit insurance unnecessary.

¶14. (U) Over the last six years, the VPSC has loaned approximately VND 30 trillion (USD 1.9 billion) to the DAF. The bank's current balance is VND 6.53 trillion (USD 411 million), with almost VND 6.05 trillion (USD 381 million) in assets with the DAF. Currently, the VPSC keeps 10 percent of its funds in reserve. The VPSC's maximum reserve requirement is 20 percent, but the company has no minimum reserve requirement.

¶15. (U) VPSC officials have also noted that the VPSC intends to expand its retail deposit services along with its customer base. Officials are hoping that the Prime Minister will approve proposals to expand payments, ATM use (using "smart-card" technology), foreign remittances and telephone payment services. In the end, the VPSC would like to transform itself into a development bank. The company is already negotiating remittance contracts to transfer money from the United States and is running a pilot ATM program.

A WEAK FOUNDATION FOR GROWTH

¶16. (U) Comment: Informed that Vietnam had a burgeoning postal savings system, the newly arrived Deputy Chief of Mission at the Japanese Embassy in Hanoi remarked that this was a policy Vietnam should not be emulating. While Japan has been struggling for years to reform its antiquated postal savings system, the VPSC in Vietnam has been steadily becoming more firmly entrenched in the country's financial sector. Because the dominant players in the financial sector are the SOCBs, the banks most vulnerable to being crowded out by the growth of the DAF and the VPSC are the joint stock banks and foreign commercial banks. Furthermore, the DAF and the VPSC represent new forms of non-market elements in the Vietnamese economy which are largely unregulated and legally ambiguous. The fact that the DAF reserves the right to lend to foreign governments is one possible abuse that is waiting to happen, and Vietnam's targeted policy lending is an invitation for corruption and waste. The fact that both organizations continue to expand is cause for concern among foreign businesses and donor communities. Though Vietnam is on the path to reform, the GVN still has not learned to trust the market. End Comment.

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